LIBRARY
SUPREME COURT, U. S.

Supreme Court, U.S.
FILED
SEP 8 1971
E. ROBERT SEAVER, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

No. 70-233

ROBERT J. HELFENBEIN and CIRCLE INVESTMENTS OF MISSOURI, INC.,
Petitioners,

VS.

INTERNATIONAL INDUSTRIES, INC., ET AL.,
Respondents.

SUPPLEMENTAL AND REPLY BRIEFS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

SHERIDAN MORGAN
DONALD H. LOUDON
1200 City National Bank Building
Kansas City, Missouri

MARK J. KLEIN
2218 Commerce Tower
Kansas City, Missouri

BARTON P. COHEN
7900 Marty
Overland Park, Kansas
Counsel for Petitioners

E. L. MENDENHALL, INC., 926 Cherry Street, Kansas City, Mo. 64106, 421-3030

TABLE OF CONTENTS

PETITIONERS' SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI—

I. "The Economic Effects of Franchising", a Monograph Recently Published by the Graduate School of Business at the University of Wisconsin under Commission from the Small Business Administration, Should Be Considered by the Court in Reviewing the Petition Herein for the Sole Purpose of Determining the Importance of the Issues Presented to the Court 1

II. The Issues Are Important to the Entire Fast Food Franchising Industry Because Many Franchisees Are Required to Purchase a Substantial Portion of Their Merchandise and Supplies from Their Franchisor or a Supplier Approved by Their Franchisor, Because Such Franchisees Have Substantially Lower Incomes Than Franchisees Who Do Not Have Such Purchasing Restrictions, and Because Numerous Franchisees Have Experienced Substantial Financial Losses, Including the Loss of Their Franchised Businesses, As a Consequence of Such Purchasing Restrictions. A Resolution of the Issues Raised by Helfenbein's Petition in Favor of Helfenbein Will Aid the Numerous Other Franchisees Who Are Suffering Losses and Who Are under Threat of Loss of Their Franchised Businesses for Reasons Attributable to Any Substantial Extent to Illegal Tying Agreements to More Readily Obtain Relief Through the Courts 3

III. Within the Fast Food Franchising Industry There Is a Great Imbalance of Power Favoring the Franchisors Over Their Franchisees. This Imbalance of Power Is Being Used to Force

Franchisees Who May Object to Illegal Franchisor Practices to Expose Their Franchises to Termination at Substantial Financial Loss to the Franchisee Owners. A Favorable Determination of the Issues Will Help Neutralize the Use of This Imbalance of Power to Achieve Illegal Franchisor Objectives 10

IV. Although the Franchise Industry Legislation Referred to in Helfenbein's Petition Was Not Acted upon by Congress, There Is Still a Demand for Congressional Action Regulating This Industry, Especially with Respect to Franchise Terminations, As Evidenced by Bills Recently Proposed in the Senate 13

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI—

I. The Decisions of This Court in *Kelly* v. *Kosuga*, Infra, and *Bruce's Juices* v. *American Can Co.*, Infra, Are Not Applicable to the Facts in the Case on Review Because:

(A) Helfenbein Seeks to Enjoin International from Bringing a Separate Eviction Action in State Court to Avoid a Multiplicity of Litigation That Will Seriously Impair His Ability to Prosecute an Antitrust Action Against International, Not to Get International's Property for Nothing When He Purported to Be Buying It. The Injunction Is Not Sought to Prevent a Counter-Claim in the Antitrust Action Seeking Eviction of Helfenbein from His Franchised Premises 17

(B) The Decisions in Both *Kelly* v. *Kosuga* and *Bruce's Juices* v. *American Can Co.* Apply Only to Charges for Fully Executed Portions of Contracts. International's

Charges for Advertising and Management Services Subsequent to Helfenbein's Renunciation of Such Services on February 5, 1968 Are Based Solely upon the License Agreement Between the Parties and Are Not for Services in Fact Performed According to Such License Agreement. They Are Therefore Severable from Charges for Goods and Services Purportedly Furnished 17

(C) Contrary to the Factual Situations in *Kelly* v. *Kosuga* and *Bruce's Juices* v. *American Can Co.*, the Case on Review Involves a Continuing Illegal Activity That Is Nurtured by International's Ability to Involve Helfenbein in Litigation in a Separate Forum 17

II. The Circumstantial Evidence Tending to Prove That International Was Motivated to Attempt Franchise Termination and Eviction by Helfenbein's Renunciation of the Tying Arrangement Was Not Considered by the Eighth Circuit. The Finding of the Eighth Circuit in This Regard Is Therefore Erroneous and Should Be Disregarded by This Court 20

III. There Is an Abundance of Unrebutted Evidence Proving That Helfenbein Lost a Substantial Amount of Money As a Result of the Tying Arrangements Imposed on Him by International 22

IV. The Court Should Permit Petitioner to Submit Additional Exhibits Not a Matter of Record in the Courts Below for the Limited Purpose of Persuading the Court That the Court of Appeals Has Decided an Important Question of Federal Law Which Has Not Been But Should Be Settled by This Court 23

V. International Has Made Unfair and Misleading Comments to the Court Regarding the *Beck-*

stead Case, Infra, in That International Has Attempted to Lead the Court to Believe Such Case Was Dismissed for Lack of General Merit When in Fact the Dismissal Was Based Solely upon the Purported Inappropriateness of the Case as a Class Action. The *Beckstead* Complaint Should Still Be Considered by the Court As Evidence of the Need for a Judicial Curtailment of the Wrongful Termination of Franchises Within the Fast Food Franchise Industry 26

CONCLUSION 27

APPENDIX D—Text of S. 2472 ..... A1

Table of Authorities

CASES

Alaska v. *American Can Co.*, 358 U.S. 224 25

Associated Press v. *Taft-Ingalls Corp.*, 340 F.2d 753 (6th Cir.), cert. den. 382 U.S. 820 19

Beckstead v. *International Industries, Inc.*, No. 993376, Superior Court of California in and for County of Los Angeles 26, 27

Bruce's Juices v. *American Can Co.*, 330 U.S. 743 (1947) 17, 18, 19, 29

Kelly v. *Kosuga*, 358 U.S. 516 (1959) 17, 18, 19, 29

Trailmobile Co. v. *Whirls*, 331 U.S. 40 24

U. S. v. *American Trucking Association*, 310 U.S. 534 25

Zahn v. *Transamerica Corp.*, 162 F.2d 36 (3rd Cir.) 25

RULES

Rule 12, U.S. Sup. Ct. Rules 24

Rule 19, Par. 1(b), U.S. Sup. Ct. Rules 24, 25

OTHER AUTHORITIES

117 Cong. Rec. S. 12775, S. 2399 (Daily Ed. Aug. 2, 1971.) 14

117 Cong. Rec. S. 13501, S. 2472 (Daily Ed. Aug. 6, 1971) 14

Ozanne and Hunt, "The Economic Effects of Franchising", University of Wisconsin Graduate School of Business, 1971 ..... 1-9, 10-13

IN THE

SUPREME COURT OF THE UNITED STATES

No. 70-233

ROBERT J. HELFENBEIN and CIRCLE INVESTMENTS OF MISSOURI, INC.,
Petitioners,

vs.

INTERNATIONAL INDUSTRIES, INC., ET AL.,
Respondents.

PETITIONERS' SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

"The Economic Effects of Franchising", a Monograph Recently Published by the Graduate School of Business at the University of Wisconsin under Commission from the Small Business Administration, Should Be Considered by the Court in Reviewing the Petition Herein for the Sole Purpose of Determining the Importance of the Issues Presented to the Court.

In late July or early August, 1971, the Graduate School of Business at the University of Wisconsin, under commission from the Small Business Administration, published a monograph entitled "The Economic Effects of Franchis-

ing." This monograph, which was authored by Urban B. Ozanne, D.B.A., and Shelby D. Hunt, Ph.D., both of whom are Assistant Professors of Business at the University of Wisconsin, is the summary of a survey undertaken of numerous franchisors and franchisees primarily in "fast-food" oriented operations, and will be referred to in petitioners' briefs as "the SBA Survey." A copy of the SBA Survey is being filed as "Exhibit 30" in this matter.

International has objected to the interjection of new exhibits at this juncture of the proceedings, and Helfenbein has replied to these objections in his reply brief herein incorporated. With respect specifically to the SBA Survey, it would be prejudicial not only to Helfenbein, but to franchisees in general, to foreclose its consideration by the Court in determining whether the issues in the action now before the Court are of sufficient importance to deserve the issuance of a writ of certiorari. This is, to counsel's knowledge, the first comprehensive study of the effects of franchising on the economy by impartial and competent observers, and much information is revealed that was only speculation previously.[1]

1. The SBA Survey, at pages 1-8 and 1-9, mentions four "major empirical studies on franchising, and several unpublished theses on franchising, but all are understood to be rather limited in scope in comparison with the SBA Survey, especially with respect to fast food operations.

II

The Issues Are Important to the Entire Fast Food Franchising Industry Because Many Franchisees Are Required to Purchase a Substantial Portion of Their Merchandise and Supplies from Their Franchisor or a Supplier Approved by Their Franchisor, Because Such Franchisees Have Substantially Lower Incomes Than Franchisees Who Do Not Have Such Purchasing Restrictions, and Because Numerous Franchisees Have Experienced Substantial Financial Losses, Including the Loss of Their Franchised Businesses, As a Consequence of Such Purchasing Restrictions. A Resolution of the Issues Raised by Helfenbein's Petition in Favor of Helfenbein Will Aid the Numerous Other Franchisees Who Are Suffering Losses and Who Are under Threat of Loss of Their Franchised Businesses for Reasons Attributable to Any Substantial Extent to Illegal Tying Agreements to More Readily Obtain Relief Through the Courts.

With regard to purchasing requirements imposed by franchisors on their franchisees, the authors of the SBA Survey state (at p. 5-21):

> A very common practice is to require franchisees to purchase operating supplies such as paper goods, foodstuffs, spices, and soft drink syrup from the franchisor. About 70% of all franchisees are required to purchase at least some of their operating supplies from the franchisor. Of those franchisees who must purchase from their franchisors, the median percentage of total operating supplies that they purchase from their franchisor is 50%. This means that 35% of the franchisees must buy less than 50% of their requirements from their franchisors, and 35% of the franchisees must buy more than 50% of their requirements from their franchisors. The remaining 30% are not required to purchase operating supplies from their franchisors. Sales of operating supplies to the franchisee represent a large source of revenue for many franchisors.

And they further stated (at p. 5-23):

> Frequently, franchisees must purchase supplies from either the franchisor *or an approved vendor.* Sixty percent of the franchisors indicated that they reserved the right to approve the franchisee's major suppliers.

The responding franchisors gave two primary justifications for requiring franchisees to buy from them: (1) savings arise to the franchisor from volume purchasing, and (2), quality control. (SBA Survey, p. 5-21). However, it is doubtful that franchisees are deriving much benefit from such restrictions. The authors of the SBA Survey state (p. 5-21):

> * * * Most franchisees do not believe that they are getting lower prices because of their franchisors' volume purchasing. Table 5-9 indicates that 47% of the franchisees who must buy from their franchisors believe that they are paying higher prices than they could obtain on their own. Only 25% believe that they are paying lower prices than they could obtain elsewhere.

And at p. 5-23 the authors state:

> * * * Franchisees who are required to buy a high percentage of their total supplies from their franchisors have significantly lower income from their units than do franchisees who are required to purchase a low percentage of their total supplies (table 5-11, test 16). The evidence suggests that having to purchase supplies from the franchisors materially reduces the franchisee's income.

This latter statement supports Helfenbein's experience in that he was able to materially reduce his food costs as a percentage of gross sales when he renounced the tying restrictions and started buying food and supplies in a competitive market.

There are no rebates involved with respect to purchases by IHOP franchisees because substantially all

sales to them are by International, even though delivery may be made by an "approved supplier." (Ex. 5; Ex. 6, p. 49). In this way, International is able to make a profit by taking a discount upon payment to the supplier. (Exs. 7-11). 41% of the franchisees responding to the SBA Survey indicated that, to the best of their knowledge, their franchisor was receiving a "commission" from some of their suppliers. (pp. 5-23, 24). In this respect, the authors of the SBA Survey stated (p. 5-24):

> The economic consequences of the prevalence of "kickbacks" is dramatically revealed when the presence of "kickbacks" is associated with franchisee income. The franchisees who believed their franchisors were taking "kickbacks" had significantly *lower* incomes than other franchisees (Table 5-11, test 17).

In a section of the SBA Survey entitled "Franchisees' Evaluation of Franchising" (starting at p. 5-28), the authors introduced their remarks with the following statement: "Many franchisees were bitter about their franchised businesses and took advantage of the franchisee questionnaire to air their greivances (sic)." There followed several examples of comments received from franchisees. Starting at page 5-29, the authors state:

> The financial consequences of a bad franchise can be devastating. The following comments come from an ice cream franchisee who bought his franchise in 1965 and was forced to purchase 75% of his supplies and merchandise from the franchisor at what he felt to be higher prices than he could purchase equivalent supplies elsewhere:
>
> > On May 8 of this year we finally sold our business, and the whole experience was a nightmare.
> >
> > The first six months we lost $4,000. Because we had put so much money in this venture we thought we could not abandon this and slowly and methodically

during this period, we sold our $25,000 home, all our stocks and bonds, and then borrowed money to keep it going.

We set the deadline at August 1970 to file for bankruptcy if we could not sell before that date—we had been trying to sell since 1966 to no avail.

We were fortunate to sell for $12,000 which just covered all the money that we owed. We have depleted all our savings, our home and we are left with no assets at all. When we signed our franchise agreement our net worth was $39,500.

The complete despair of a franchisee who is "locked" into what she believes to be an inequitable contract and must buy 90% of her supplies from her franchisor is graphically described by a lady who signed herself as "Hopeless":

The . . . National Bank president looked at our contract with [name of franchise system] as we would like out. He never saw a contract so one sided; it would be hopeless to find a buyer and it [would] cost too much to buy them out so we have to keep going or walk out. How long can we last! I wish someone would look into this operation—a lawyer is not the answer because they are not sure either—but we are trapped.

Of direct concern to the economy of the country is the failure rate of businesses within it. Determining the failure rate of small businesses in general, or of a named industry in particular, is exceedingly difficult because there are many businesses that are sold that could possibly have been called "failures." Business turnovers is a statistic more readily ascertainable. For purposes of the SBA survey, a "turnover" was a transaction in which ownership of a franchised outlet changed or in which the outlet was discontinued. (SBA Survey, p. 3-25).

At pages 14 and 15 of petitioners' brief, turnover among IHOP franchisees was discussed. The statistics were all derived from Exhibit 26, various documents which were a matter of record in the courts below.

The SBA Survey dwells further on the failure rate and turnover rate among franchisees. Certain of the conclusions and findings of the authors will here be discussed.

Franchisee turnover was 7.1% in 1968 and 6.7% in 1969. (SBA Survey, p. 3-26). A calculation of the actual failure rate of franchisees was considered by the authors to be impossible. However, they concluded that the failure rate ranged between 1.3% and 7.1% in 1968 and between 1.3% and 6.7% in 1969, and opined that this estimate was probably too low because of the greater inclination of "ethical" franchisors to answer than "unethical franchisors" and because franchise systems that had failed could not answer. (SBA Survey, pp. 3-27 and 3-28).

The authors made several comments regarding "Franchising: The Odds-on Favorite," a book written by J. F. Atkinson and published by the International Franchise Association (an association of franchisors) in 1968. This book contains a number of statistics regarding franchisee failure rates based upon franchisor furnished information. Comparison was made in Atkinson's book between the failure rate for franchisees and the failure rate represented to be that of all business firms. The SBA Survey concluded that Atkinson's book "makes erroneous comparisons with overall retail trade failure rates, which would be completely misleading when read by potential franchisors (sic)." (SBA Survey, pp. 3-29 and 3-30). In fact, the authors stated (p. 3-29): "Actually, the Atkinson study—if it shows anything—shows that franchised units fail 'faster' than retail trade as a whole * * *." The authors

of the SBA Survey, in their general recommendations, stated (at p. 2-37):

> 8. We recommend that the International Franchise Association withdraw from circulation all copies of the book *Franchising: The Odds-On Favorite*, by J. F. Atkinson. The book presents grossly inaccurate data on failure rates and would be very misleading to potential franchisees.

The franchisors have apparently been making general use of Atkinson's study to encourage potential franchisees to purchase franchises.

These comments are made regarding the Atkinson survey not as a critique of the survey, but to illustrate how potential franchisees have apparently been misled into believing they were purchasing a greater amount of security upon acquiring a franchised business than could be obtained by going into business on their own. It follows that these franchisees need not only the protection that hopefully will be afforded by the plethora of legislation affecting the franchise industry that has either been passed or proposed in recent years, but also pronouncements by this Court in matters such as Helfenbein's attempt to consolidate the multiple and vexatious litigation in which he is ensnarled into one Court competent to hear all issues so that he can be adequately represented on all issues.

Helfenbein in no way intends these remarks to indict the entire franchise industry. The SBA Survey indicates that 65.4% of the responding franchisees "are sufficiently satisfied with their franchised businesses that 'if they had to do over again,' they would still choose to be franchisees with their present systems (Table 5-10)." (p. 5-32). The sampling of letters published however, and the fact the authors stated "Many franchisees were bitter" indicates that there are many franchisees, or former

franchisees, who have lost substantial sums of money in their franchised businesses. The letters published also indicate that such losses are often attributable to tying requirements imposed by the franchisors. This conclusion is further supported by the findings that franchisees who are required to purchase a substantial amount of their supplies from their franchisor had materially reduced income (p. 5-23), and that franchisees who believed their franchisors were receiving "kickbacks" from their suppliers had significantly lower incomes than other franchisees. (p. 5-24).

The courts so far have not provided an answer. To have very liberal laws in favor of antitrust claimants is one thing. To be able to take advantage of these laws is something else. At page 8-5 of the SBA Survey, the response of one franchisee summarized the problem quite succinctly:

> [Name of system] blatantly uses fraudulent sales pitches and figures to sell their franchises. Right now I am in a position of losing my entire investment because they sold me a bill of goods. The cost of lawsuits is a burden (I have spent in excess of $7,500.00) and seems to be of no avail, because they are so big and have so much money they can wait until you simply can't afford to fight anymore and then settle for very little. I am faced at this point with little choice but to find a job and abandon my fight, although I have made many gains for franchise holders in [franchisee's geographical area].

III

Within the Fast Food Franchising Industry There Is a Great Imbalance of Power Favoring the Franchisors Over Their Franchisees. This Imbalance of Power Is Being Used to Force Franchisees Who May Object to Illegal Franchisor Practices to Expose Their Franchises to Termination at Substantial Financial Loss to the Franchisee Owners. A Favorable Determination of the Issues Will Help Neutralize the Use of This Imbalance of Power to Achieve Illegal Franchisor Objectives.

The threat and inception of eviction proceedings against Helfenbein by International is the continuation of an imbalance of power relationship that exists in the fast food franchise industry between franchisor and franchisee. With respect to this imbalance of power, the authors of the SBA Survey state (pp. 2-26, 2-27):

> Some franchisors keep the contents of their agreements inviolate and non-negotiable and are unwilling to have it examined before the prospective franchisee has paid a nonreturnable deposit toward purchase. This attitude sets the tone of a relationship between franchisor and franchisee that is noteworthy for the power imbalance in favor of the franchisor. The power imbalance is apparent during contract negotiations and extends over the term of the relationship. Not only is the franchisee economically inferior to the franchisor, but he suffers from an information inferiority because the franchisor understands the implications of the agreement he has devised, has experience in negotiating, and provides the bulk of the information about the franchise.
>
> The imbalance between franchisor and franchisee extends to the franchise agreement itself. The typical franchise agreement imposes far more obligations on the franchisee than on the franchisor. Moreover, the franchisee obligations are specified more closely and in greater detail, while the franchisor obligations

tend to be vague and are hedged in limiting phrases. Results from the franchisor questionnaire suggest that most franchisors do enforce the many franchisee obligations (see Table 8-1), and, even if the franchisors did not enforce all franchisee obligations, the clauses are there as a threat and could be used to eliminate unruly franchisees.

Helfenbein's License Agreement (Ex. 1-B) is an ideal example of the one-sided type of License Agreement of which the authors of the SBA Survey speak. There are many specific obligations on Helfenbein, and comparatively few obligations of a vague nature on International.

The power imbalance is exemplified especially by the provisions concerning arbitration, termination of license, etc. There is a very broad arbitration clause, Article XIH. This, in and of itself, is recommendable. But arbitration is required in Los Angeles, California. International's headquarters. How can a franchisee distantly removed from Los Angeles, California possibly be represented adequately if he must arbitrate in that city? This is a distinct advantage to International.

The advantage does not stop there. In a proviso to the arbitration clause, International reserves the right "to apply to any court of competent jurisdiction for appropriate writs for recovery of possession of the premises" without first seeking arbitration. Helfenbein has certain financial obligations to International that are required by Paragraph A, Article IV, of his License Agreement to be satisfied. These include payment of equipment rent, management and advertising fees, etc. Article VIII of the License Agreement provides for termination of the license in the event of breach of its terms. And Article II of the premises sublease (Ex. 1-F) provides for termination of the sublease at the option of International in the event the License Agreement is terminated. International has followed the

foregoing course in seeking to evict Helfenbein. (Exs. 1-K, 1-M).

The power of franchise termination (and resulting eviction from the franchised premises) is the extreme manifestation of the power imbalance. In the SBA Survey, it was reported that only 118 (12.9%) of the 915 responding franchisees had ever been threatened with revocation of their franchise. The authors continued, "However, some franchisees may feel an implied threat of termination, because of the way most franchise agreements dwell on the franchisor's right to terminate." (p. 8-20). In answer to a question regarding the need for federal legislation to restrict franchise termination, 76.7% of the franchisees responded that such legislation was very necessary or necessary. In this regard, the authors commented: "Apparently, most franchisees feel insecure in their franchise and desire greater protection from arbitrary cancellation." (p. 8-21).

Along the same line, the SBA Survey indicated (p. 8-7) "Relatively few franchisors reported that the requirements (of their contracts and operating manuals) were 'not strictly enforced' (Table 8-1). * * * However, if franchisors did not enforce all franchisee obligations, the clauses are there as a threat and could be used to eliminate unruly franchisees." (Parenthetical remarks supplied.)

And at page 8-19 of the SBA Survey the authors state, with respect to termination clauses: "Moreover, there is always the issue of unequal application, i.e., enforcing a particular clause to get rid of a recalcitrant franchisee when the same defaulting behavior is ignored in other franchisees."

It is this very discrimination that Helfenbein claims is being practiced against him by International. It is one thing for the courts to merely enforce the sanctity of

contracts, and quite another to enforce the sanctity of a harsh termination clause in a contract of adhesion in a manner that is likely to discourage other franchisees from challenging in any way the legality of their license agreements or of the practices of their franchisor. Helfenbein's purpose in seeking the preliminary injunction against a separate eviction proceeding is an attempt to neutralize the one-sided provisions in his license agreement and related contracts. If the preliminary injunction is granted, International will have to choose between filing in the U.S. District Court wherein the antitrust action is filed a counter-claim seeking possession of the premises, or in awaiting the outcome of the antitrust action before filing for eviction in state court. In this way all of the antitrust issues can be consolidated in one tribunal. In no way does the preliminary injunction permit Helfenbein to avoid paying for something he has purported to purchase!

Helfenbein claims that his position is so common to that of other franchisees, especially to the large number in the fast-food industry, that the issues deserve the attention of this Court.

IV

Although the Franchise Industry Legislation Referred to in Helfenbein's Petition Was Not Acted Upon by Congress, There Is Still a Demand for Congressional Action Regulating This Industry, Especially with Respect to Franchise Terminations, As Evidenced by Bills Recently Proposed in the Senate.

Certain franchise industry oriented legislative bills were referred to in Helfenbein's petition for writ of certiorari, but none of these bills were voted upon prior to the time Congress closed. The need is still there for such legislation, as evidenced by the proposal by the Honorable Harrison A. Williams, Jr., U. S. Senator from New Jersey, on August 2, 1971, of the Franchise Fair Practices Act, S.

2399, 92nd Congress, 1st Session.[2] This bill is described as follows (117 Cong. Rec. S. 12775 [daily ed. Aug. 2, 1971]):

> S. 2399. A bill to require under the supervision of the Federal Trade Commission a full and a fair disclosure of the nature of interests in business franchises, to provide increased protection in the public interest for franchises in the sale of business franchises and to provide for fair competitive practices in the operation of franchise businesses and the termination of franchise agreements.

And on August 6, 1971, the Honorable Philip A. Hart, United States Senator from the State of Michigan, introduced the "Fairness in Franchising Act," S. 2472, 92nd Congress, 1st Session[3], "A bill to supplement the antitrust laws of the United States by providing for fair competitive practices in the termination of franchise agreements." 117 Cong. Rec. S. 13501 (Daily ed. Aug. 6, 1971). Senator Hart introduced S. 2472 with the following remarks (117 Cong. Rec. S. 13501 (Daily ed. Aug. 6, 1971)):

> FAIRNESS IN FRANCHISING ACT
>
> Mr. HART. Mr. President, $1 out of every $4 a consumer spends for goods these days goes into the pocket of a franchised business.
>
> This includes purchases ranging from gasoline to chicken, from automobiles to temporary office help.
>
> All told, consumers spend more than $100 billion each year with franchised operations.
>
> Obviously, franchising is a significant segment of our economy. Yet, because it really blossomed only in recent years and because it often has been more the

2. As of the date this supplemental brief is being written, petitioners do not have a copy of the Franchise Fair Practices Act.

3. The Fairness in Franchising Act has been reprinted in Appendix D, pp. A1-A5.

subject of advertising puffery than of exacting scrutiny, few safeguards have been built into the system.

Let us face it, franchising was a distribution system developed for the benefit of entrepreneurs. It grew not from the grassroots up but from the central seats of power down.

Therefore, it should not be surprising that much in the system is feudal in concept. A glance at most of the more than 700 different franchise agreements floating around in this country will substantiate that.

"The franchisee shall" is the most common phrase throughout the contracts. And, unfortunately, it often is only after that "said franchisee" has been in business a while that it begins to dawn on him that the onus to perform is chiefly on him.

Franchisees are controlled by contract to such extents as source of supplies, hours of operation, cleaning techniques, number of employees, selection of vending machines, territories of operation, and sometimes even prices to be charged.

For this "independence," the franchisee is allowed to put up the capital and frequently to work hours far in excess of those any employee would legally be allowed.

As one franchise agreement spelled it out:

In no event shall the franchisor ever be liable to franchisees for any claims of whatever nature.

The franchisee is kept in line with a very powerful weapon:

Cancellation—or the threat of cancellation.

Faced with the loss of his investment—or both money and time—plus the ignominy of failure, franchisees "go along in order to get along."

But, under the law as it stands today even "going along" and doing a very good job for the franchisor

at the same time is no protection against losing the business.

Termination—or refusal to renew—is commonplace in franchising.

* * *

We emphasize the legislative activity in Congress with regard to proposed franchise industry legislation because it points up the crying need of franchisees for help in defending themselves from wrongful termination of their franchises. And when we speak of "wrongful terminations," we include terminations arising out of franchisees' inability to meet financial obligations to franchisors because of losses suffered as a result of burdensome illegal tying agreements imposed by the franchisors, and we speak of the selective termination of recalcitrant franchisees in an attempt to force prompt and favorable settlement of antitrust suits so that they can be classified merely as nuisance type litigation, to eliminate non-conformist franchisees who renounce the illegal tying agreements, and to keep the other franchisees in line. Helfenbein falls in each of these categories. And although legislation in the area is certainly desirable, it is not the only answer, and the Courts are shirking their responsibility if they pass the buck to the legislators. There is no reason why the Courts cannot tell a franchisor in appropriate cases, and we submit that Helfenbein's is appropriate, that if they desire to rid themselves by means of an unlawful detainer action of a franchisee who is also an antitrust claimant against the franchisor, that the franchisor will not be able to harass that franchisee by involving him in multiple lawsuits. The franchisor will be permitted to promptly file and prosecute his unlawful detainer action as a counter-claim in the antitrust suit, or if the franchisor chooses, it can await the outcome of that suit, and absent a decree to the contrary in the antitrust action, file and prosecute its unlawful detainer action in the state courts. The appropriate circumstances for such an injunction are discussed at pp. 19-20 in petitioner's reply brief.

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

The Decisions of This Court in Kelly v. Kosuga, Infra, and Bruce's Juices v. American Can Co., Infra, Are Not Applicable to the Facts in the Case on Review Because:

(A) Helfenbein Seeks to Enjoin International from Bringing a Separate Eviction Action in State Court to Avoid a Multiplicity of Litigation That Will Seriously Impair His Ability to Prosecute an Antitrust Action Against International, Not to Get International's Property for Nothing When He Purported to Be Buying It. The Injunction Is Not Sought to Prevent a Counter-Claim in the Antitrust Action Seeking Eviction of Helfenbein from His Franchised Premises.

(B) The Decisions in Both Kelly v. Kosuga and Bruce's Juices v. American Can Co. Apply Only to Charges for Fully Executed Portions of Contracts. International's Charges for Advertising and Management Services Subsequent to Helfenbein's Renunciation of Such Services on February 5, 1968 Are Based Solely upon the License Agreement Between the Parties and Are Not for Services in Fact Performed According to Such License Agreement. They Are Therefore Severable from Charges for Goods and Services Purportedly Furnished.

(C) Contrary to the Factual Situations in Kelly v. Kosuga and Bruce's Juices v. American Can Co., the Case on Review Involves a Continuing Illegal Activity That Is Nurtured by International's Ability to Involve Helfenbein in Litigation in a Separate Forum.

International makes much to do about the application of *Kelly* v. *Kosuga*, 358 U.S. 516 (1959), and *Bruce's Juices* v. *American Can Co.*, 330 U.S. 743 (1947), to the facts

in the case presently on review. The issue is not whether Helfenbein is trying to use Section 16 of the Clayton Act, 15 U.S.C., Sec. 26, to get something for nothing, as International tries to persuade the Court. Helfenbein merely wants to place all the issues before one court competent to hear all the issues; namely, the United States District Court for the Western District of Missouri. International insists upon litigating the eviction issue in the courts of the State of Missouri. Their counsel stated at the hearing on Helfenbein's request for preliminary injunction "We are asking this Court only to allow the parties to litigate *in the forum provided therefor* such disputes which they may have which do not touch upon the matters before this Court." (Tr. 33, A. 71). (Emphasis supplied.)

Helfenbein has no complaint against the courts of the State of Missouri. His complaint is against multiple litigation of inter-related issues. As stated at page 18 of his initial petition to this Court, he has certain equitable defenses to the eviction which require proof substantially identical to the proof that will be required in his antitrust case. These equitable defenses arise under Missouri law, not under the Federal antitrust law. In *Kelly* v. *Kosuga*, supra, l.c. 358 U.S. 519, this Court held that "state law governs the rights and duties of sellers and purchasers of goods * * * ." We assume this Court would just as readily hold that state law should govern in general the rights and duties of landlords and tenants.

In arguing the applicability of this Court's decisions in both *Kelly*, supra, and *Bruce's Juices*, supra, International has relied upon the premise that all of the goods and services with respect to which Helfenbein has been charged and which must be paid in order to avoid eviction have in fact been performed. (Resp. p. 11, 12, 15, 16). But the undisputed fact is that subsequent to February 5, 1968, no adver-

tising or management services were furnished by International to Helfenbein. Of the $75,000 claimed due for goods and services, about $30,000 represents charges for unperformed advertising and management services arising solely out of claimed post-February 5, 1968 contractual obligations which obligations had been renounced. (Ex. 1, p. 4; A. 68-70).[4] These are the charges Helfenbein claims to be severable, and as to which this Court's decisions in *Kelly,* supra, and *Bruce's Juices,* supra, have no bearing. These charges are, in fact, severable, and International may not obtain judgment for them. *Associated Press* v. *Taft-Ingalls Corp.,* 340 F.2d 753, (6th Cir.), cert. den. 382 U.S. 820.

This Court's decisions in both *Kelly,* supra, and *Bruce's Juices,* supra, are not applicable for yet another reason. In both of those cases the activities or transactions that were purportedly illegal under the Federal antitrust laws had ceased. In the case at bar, the illegal activity continues, and is nurtured by the tortfeasor's ability to involve its franchisees in multiple and vexatious litigation.

A franchisee has enough problems merely prosecuting an antitrust suit against a much larger and much more powerful franchisor. Must he also bear the expense, burden and worry of defending a completely separate eviction action in a separate court at the same time? The injunction against a *separate* eviction action should be issued if the claimant can satisfy the court in the following respects: (1) that the litigation to be enjoined will in and of itself be an aid to the antitrust defendant in imposing its requirements allegedly in violation of the antitrust laws on the claimant and/or other parties; (2) that there is substantial likelihood that the allegations of the antitrust

4. A more comprehensive discussion regarding the charges for renounced and unperformed services is contained in Helfenbein's Petition for Rehearing to the Eighth Circuit, pages 2-4.

claim will be sustained at trial on the merits, and that (a) the purportedly illegal conduct of the antitrust defendant caused the deficiencies alleged by the antitrust defendant as justification for the eviction action (i.e., delinquency in paying rent or other obligations to the antitrust defendant), or (b) the eviction action was brought in retaliation for the activities of the claimant in opposition to the purportedly illegal activities of the antitrust defendant (i.e., the filing of an antitrust action or the renunciation of tying requirements); and (3), that the separate prosecution of the eviction action in a court other than that in which the antitrust action has been filed will result in multiple litigation over identical issues (i.e. the activities of the antitrust defendant purportedly in violation of the antitrust laws) that will severely impair the ability of the antitrust claimant to prosecute his claim.

II

The Circumstantial Evidence Tending to Prove That International Was Motivated to Attempt Franchise Termination and Eviction by Helfenbein's Renunciation of the Tying Arrangement Was Not Considered by the Eighth Circuit. The Finding of the Eighth Circuit in This Regard Is Therefore Erroneous and Should Be Disregarded by This Court.

International's brief dwells on the finding of the Eighth Circuit that "There is no evidence that the eviction proceeding is based upon plaintiffs' refusal to continue to buy according to any tie-in agreement." (App. A, p. A6). Apparently, the Eighth Circuit would require franchisees to furnish direct evidence that a franchisor/landlord was using its control over the franchised premises to coerce franchisees into compliance with illegal restrictions. The existence of International's controls over Helfenbein's premises has not been contested by International.[5] The

5. For more discussion regarding these controls, please refer to pages 13-15 of respondents' brief to the Eighth Circuit and pages 5 and 6 of respondents' brief to this Court.

issue arises as to the reason International is attempting to exercise these controls against Helfenbein.

Helfenbein did not offer any direct evidence concerning International's reason for attempting to evict him. But to require evidence of this nature at a preliminary injunction hearing as a condition of issuing the injunction is to impose an unreasonable burden on a franchisee. This is especially true in the instant action, and the circumstantial evidence should be considered. The evidence proved beyond any doubt that International was soliciting and receiving rebates from suppliers to IHOP franchisees, including Helfenbein (Ex. 7-11), that International imposed tying restrictions on its IHOP franchisees with respect to substantially all food, supplies, equipment, and services required for the operation of their restaurants (Ex. 1, pp. 2-5; Ex. 1-B, p. 3; Ex. 1-D), that Helfenbein had renounced such restrictions on February 5, 1968 (Ex. 1, p. 4), that Helfenbein had suffered substantial losses beyond the financial delinquencies to International as a result of such restrictions prior to the renunciation and was able to effect substantial savings after the renunciation (Ex. 1, pp. 3-5; Ex. 2), that International very strictly enforced the requirements of its license agreements and operating manuals (Ex. 3, pp. 6-8), that the failure of an IHOP franchisee to abide by such requirements could result in termination of his franchise and eviction from his franchised restaurant without prior arbitration,[6] and that he could avoid the eviction proceeding only by paying International all that International claimed was due, including the contractual charges for management and advertising services that had been renounced and weren't even being provided.[7]

6. Supra, p. 11, petitioners' supplemental brief.

7. Mr. Gershon, counsel for International, stated at the hearing on the preliminary injunction:

The Eighth Circuit ignored all of the foregoing circumstantial evidence in arriving at its conclusion. International should not be permitted to capitalize on this error to the substantial prejudice of Helfenbein.

III

There Is an Abundance of Unrebutted Evidence Proving That Helfenbein Lost a Substantial Amount of Money As a Result of the Tying Arrangements Imposed on Him by International.

Respondents take issue with the existence and proof of losses suffered by Helfenbein as a consequence of the tying arrangement imposed upon him by International. In petitioners' brief only slight mention was made (at p. 6) of these losses, assuming at the time that, in view of the overwhelming evidence before the District Court, respondents would not have the audacity to deny them. The Court's attention is directed to the following:

(1) A "confidential" bulletin from Leon Gottlieb, National Licensing Director of International, directed to Area Licensors and Regional Directors, dated December 17, 1964, admitting that International has been receiving a "discount or rebate" from suppliers to its franchisees and requesting the Area Licensers and Regional.Directors to continue this practice. (Ex. 7). No attempt was made to rebut this evidence.

(2) A series of letters and other documents proving that International was receiving a "rebate" of almost 8 per cent on all dairy purchases by its IHOP franchisees in the Kansas City area through May 22, 1967 (soon after the time this scheme was discovered

---

"* * * If in fact the plaintiff has a valuable investment, which he seeks to preserve, he has two remedies for it. The first is to pay what he owes, seek his remedies in this court and continue his operation, and we would be delighted to permit him to do so. * * *" (Tr. 33, A. 70).

by one of the franchisee victims). (Ex. 8-11). No attempt was made to rebut this evidence.

(3) The computations by Matthew T. Kearney, CPA, the accountant for Helfenbein, showing that Helfenbein after renouncing the illegal tying requirements, reduced his food costs in his Kansas City restaurant from 35.5% of food sales to 29.0%, and in Des Moines from 36.9% to 32.9%. Mr. Kearney, on the basis of this experience, then estimated that Helfenbein had lost $10,700 on food purchases alone prior to renouncing the illegal restrictions. However, on re-examination of his computations, it is obvious on their face that the loss should be closer to about $35,000. Mr. Kearney had erroneously applied the savings in food costs percentage against purchases instead of against sales. (Footnote (1), Ex. 2-A). This loss, it should be emphasized, was on food purchases only. It doesn't include the losses Helfenbein also suffered on purchases of supplies, etc. from International, nor does it include losses arising out of rental of equipment or from management and advertising service charges paid to International, all of which, out of necessity had to be estimated for purposes of the hearing on the request for temporary injunction. (Ex. 1, pp. 3-5; Ex. 2; Ex. 2-A). Rather than attack the theory upon which these estimates were made, International has chosen to castigate the parties who made them. The estimates therefore stand unrebutted.

IV

The Court Should Permit Petitioner to Submit Additional Exhibits Not a Matter of Record in the Courts Below for the Limited Purpose of Persuading the Court That the Court of Appeals Has Decided an Important Question of Federal Law Which Has Not Been But Should Be Settled by This Court.

The respondents would have the court limit the exhibits to be considered with respect to a petition for writ of certiorari to the record on which the case was submitted

to the District Court, and cite as authority for this statement Rule 12, U.S. Sup. Ct. Rules. (Resp. Br. p. 8). Rule 12 pertains to certification of the record below. It does not limit the exhibits that may be considered.

One of the criteria for determining if a writ of certiorari should be issued is whether the Court of Appeals below "has decided an important question of federal law which has not been, but should be, settled by this court; * * * ." Par. 1(b), Rule 19, U.S. Sup. Ct. Rules. The importance of the question presented is not an issue in the courts below, only the merits. In fact, petitioners were precluded by the District Court from even discussing or arguing the importance of the issues to franchisees, in general, all over the country. (Tr. 58, 59).

International's sole objection to Exhibits 16 through 29, inclusive is that none "were before either the District Court or the Court of Appeals." (Resp. p. 8). This is not entirely true. Exhibit 26 was part of the record before both the District Court and the Eighth Circuit. As to the other named exhibits, we contend they are appropriate for consideration for the reasons that follow.

Some of the exhibits contain evidence of matters and transactions that occurred subsequent to the hearing on the request for preliminary injunction. These include the various financial statements for periods ending September 30, 1969, 1970 and 1971 (Exs. 18-20), International's complaint in the unlawful detainer action against Helfenbein (Ex. 21), the Beckstead complaint (Ex. 27), and the rent check to International (Ex. 28). There are circumstances where it is appropriate to set out relevant matters that occurred subsequent to the compilation of the record in the courts below. For example, reference is made to *Trailmobile Co.* v. *Whirls*, 331 U.S. 40, 48, where certain exhibits concerning events that occurred subsequent to considera-

tion of that case by the Court of Appeals were considered by this Court for the purpose of determining whether the controversy was moot. It is realized that this does not justify consideration of the financial statements for the periods ended September 30, 1967 and 1968. As to all of the financial statements, it is important to consider them to show the effect of the removal of tying restrictions on franchisees, in general. Such information with respect to franchisees in general simply was not available when petitioners' brief was written, and it was considered appropriate under the circumstances to recite this information as to Helfenbein only. And as to all of the additional exhibits, they should be considered for the sole purpose of determining the importance of the "question of federal law which has not been, but should be, settled by this court." Par. 1(b), Rule 19, U.S. Sup. Ct. Rules.

We respectfully request the Court to take judicial notice of the complaints filed in International's unlawful detainer action against Helfenbein (Ex. 21), and in the Beckstead case. (Ex. 27). This Court has apparently not previously ruled upon whether it will take judicial notice of the pleadings of record in a completely separate action. However, such pleadings are a matter of public record. They are therefore offered as proper subjects for judicial notice. c.f. *Zahn* v. *Transamerica Corp.*, 162 F.2d 36, 48 (3rd Cir.), note 20.

Further, we respectfully request the Court to take judicial notice of the various copies of bills proposed to Congress which were attached as Exhibits 22 through 25, inclusive. In earlier cases this Court has taken judicial notice of the history of legislation. *Alaska* v. *American Can Co.*, 358 U.S. 224, 226, 227; *U.S.* v. *American Trucking Association*, 310 U.S. 534, 547. Although the various proposed bills contained on the exhibits offered by Helfenbein

have not as yet been enacted into legislation, we submit it is just as logical to give judicial notice to the history of legislation that has not as yet been enacted as it is to give judicial notice to the history of enacted legislation.

Exhibit 29 is an article which is, in effect, a summary of the various state laws and regulations affecting franchising that have been enacted or that have recently been proposed or put under study. Again, it is submitted and contended to be appropriate for the sole purpose of showing this Court the importance of deciding the issues presented by Helfenbein's petition.

V

International Has Made Unfair and Misleading Comments to the Court Regarding the Beckstead Case, Infra, in That International Has Attempted to Lead the Court to Believe Such Case Was Dismissed for Lack of General Merit When in Fact the Dismissal Was Based Solely Upon the Purported Inappropriateness of the Case as a Class Action. The Beckstead Complaint Should Still Be Considered by the Court As Evidence of the Need for a Judicial Curtailment of the Wrongful Termination of Franchises Within the Fast Food Franchise Industry.

Petitioners complain about the fairness of the comments respondents make in their brief (at p. 8) concerning the *Beckstead* case (*Beckstead* v. *International Industries, Inc.*, No. 993376, Superior Court of the State of California in and for the County of Los Angeles) previously referred to by petitioners. (Pet. Br. p. 15). In attempting to completely deflate the importance and pertinence of the *Beckstead* case, and to wrongfully belittle counsel for petitioners in the eyes of the Court, respondents stated with respect to that case:

> "* * * We are filing with this Court a copy of the Clerk's Docket Sheet, attested to by him which shows that, on May 28, 1971, the complaint in *Beckstead* was

> dismissed on demurrer. We make this comment in view of the extensive discussion of *Beckstead* by Petitioners (Pet. pp. 15-17), and petitioners' failure to advise this Court of the dismissal of the *Beckstead* complaint."

The Clerk's Docket Sheet filed by respondents shows on its face that the *Beckstead* case was dismissed only because of the class action nature of its contents, and that plaintiffs were given leave to refile on the merits of their individual complaints.[8] Of what pertinence, therefore, is the dismissal to petitioners' original comments regarding that case? And even if such dismissal was pertinent, it occurred on May 28, 1971, about four days before the actual filing of Petitioners' brief, and petitioners' counsel were unaware of such dismissal until receipt of respondents' brief.

The Beckstead complaint therefore remains as evidence of the need for a judicial curtailment of the wrongful termination of franchises by franchisors within the fast food franchise industry.

CONCLUSION

Franchising is a significant segment of the American economy. Many franchisees are required by their franchisor to purchase substantial portions of their supplies from their franchisor, or from a purveyor approved by their franchisor. Such franchisees have significantly lower incomes than others who are not burdened with similar restrictions. Further, many franchisees have lost

---

8. The entry on the Clark's Docket Sheet in the *Beckstead* case referred to at page 8 of respondents' brief and filed by respondents as an exhibit states, in pertinent part:

> Demurrers and each of them are sustained, on grounds stated therein, without leave to amend as to the rights in the Class Action, with leave to amend as to right to file on behalf of individually named Plaintiffs. Plaintiff has 60 days to amend.

considerable amounts of money invested in their franchises, oftentimes their life savings, and a substantial reason for such losses are the tying agreements imposed by franchisors. There is a great imbalance of power between franchisors and franchisees. One-sided license agreements permitting franchisors to terminate franchisees and evict them from their franchised businesses are used to keep franchisees in line, to discourage litigation challenging the tying requirements imposed by the franchisor, and to harass with multiple and vexatious litigation those franchisees who do challenge the system or who are no longer willing or able to abide by it. Numerous small businessmen are thereby removed from business, and the entire American economy is adversely affected to a substantial degree. These are the conclusions one can draw from the evidence discussed in petitioners' supplemental brief.

In the case on review, Helfenbein, after finding the tying requirements too burdensome a system to honor, and after suffering losses that caused him to become delinquent in meeting his financial obligations to International, renounced such tying requirements, and subsequently challenged such requirements by means of this litigation. International's response to his actions has been an attempt to remove him from his restaurant by means of unlawful detainer action in the courts of the State of Missouri. Such litigation could be avoided only by paying the entire indebtedness claimed due by International, including certain severable service charges for illegally tied services that were renounced and have not in fact been performed by International. The defense of such litigation by Helfenbein would require proof substantially identical to the proof of his antitrust suit against International. To undertake the defense of this litigation in a separate court

action would unduly burden Helfenbein and severely impair his ability to prosecute the antitrust action. Such separate action should therefore be enjoined; however, International should be permitted, if it so desires, to file a counterclaim in the antitrust action seeking possession of Helfenbein's restaurant premises. Helfenbein does not desire to use the Federal antitrust laws to obtain something for nothing, only to avoid multiple and vexatious litigation.

The Courts below have refused the requested relief, basing their refusal primarily on this Court's decisions in *Kelly* v. *Kosuga,* 358 U.S. 516 (1959) and *Bruce's Juices* v. *American Can Co.,* 330 U.S. 743 (1947). The injunction, however, does not offend such decisions. Further, such decisions are inapplicable to the severable charges for the renounced illegally tied services that were not performed. And lastly, the failure to grant the injunction will help perpetuate the continuance of the illegal tying arrangement. For the foregoing reasons, this Court's decisions in the two cited cases should be clarified.

This is not, and should not be treated by the courts as a simple unlawful detainer action by a landlord for failure of a tenant to pay rent. The courts should recognize that much more complicated factors are involved in the attempted removal of a franchisee by his franchisor/landlord. The franchisor should not be permitted to recover the premises if the financial delinquencies of the franchisee arose out of the burden of illegal tying restrictions, or if the claimed breach of the license agreement arises out of a renunciation of the illegal tying requirements and subsequent failure to pay severable charges for illegally tied services that were not furnished. And lastly, the much more powerful franchisor should not be permitted to use its leverage to involve the franchisee in multiple litigation over such issues.

The issues surrounding the attempted termination of Helfenbein's franchise are important to the entire franchising community, and deserve the attention of this Court.

Respectfully submitted,

SHERIDAN MORGAN
DONALD H. LOUDON
1200 City National Bank Building
Kansas City, Missouri
MARK J. KLEIN
2218 Commerce Tower
Kansas City, Missouri
BARTON P. COHEN
7900 Marty
Overland Park, Kansas
Counsel for Petitioners